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to Tim Hauser

room _____ date _____

Department
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Office of the
Assistant Secretary
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^{SIG-IEP}
(17 MARCH)
For discussion at Thursday's 10:00
meeting.

Director

room 4450
ext 2611

3/15/83

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~~SECRET~~Polish Debt Rescheduling

Toward the end of 1982 pressure began to mount for rescheduling Poland's debts. Several Allied governments, particularly their finance ministries, argued for rescheduling on the grounds that it is better to collect some small portion of the debt through rescheduling rather than provide 100 percent de facto rescheduling as is now the case. Non-NATO governments have expressed their discontent over the NATO declaration on rescheduling because that declaration was formulated in a military alliance to which they do not belong. They too are anxious to collect some portion of the debts due them and to open lines of credit for sales to help their depressed export industries.

This paper sets forth the financial situation of Poland in 1982 and 1983, particularly the status of payment to Poland's creditors, and examines the possible range of financial options we can pursue.

1982

In 1982 Poland's economic activity continued to decline in part because of the country's inability to obtain foreign exchange or credit for purchase of imports required as inputs to production for domestic use or for export. This shortage of foreign exchange also meant that creditors were not paid or only partially paid. For example, none of the Paris Club creditors received payment on principal and interest falling due in 1982, nor did they collect the interest on the 1981 rescheduled debts.

Commercial banks, however, did receive interest payments on 1982 maturities -- \$330 million in November and \$352 million in December. A third installment of \$419 million of interest is expected to be paid March 20, 1983. (By the terms of a separate agreement, the banks have agreed to provide short-term credits equal to one-half of the interest received.) The commercial banks also received payment of 1981 interest which was in arrears and interest on the 1981 bank rescheduling totalling \$680 million.

The banks have received no payments of 1982 principal since 95 percent of the principal has been rescheduled and payment on the remaining 5 percent has been deferred into two equal payments due August and November, 1983.

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We do not know whether other creditors e.g., Brazil, Argentina, the Arab and Socialist countries have received payment (or provided new credits).

1983

In 1983 the Polish financial situation is expected to be pretty much the same as was the case last year. Poland is forecast to earn \$1,400 million net on its trade and invisible account (excluding interest), while facing payments of \$14.8 billion. If all creditors were to have equal access to these limited resources, they would obtain approximately ten cents on the dollar. However, the commercial banks are moving forward to negotiate a rescheduling agreement with Poland on 1983 maturities which could preempt the bulk of Poland's hard currency earning leaving few hard currency resources for other creditors. If the terms of the 1983 rescheduling are comparable to the 1982 rescheduling, the banks will be taking \$1,132 million net out of Poland in 1983, an amount equivalent to nearly one-third of debts falling due to them.

With an \$1,132 million bank take out, and \$1.4 billion available in hard currency, that leaves \$300m for all other creditors, assuming no other sources of financial assistance -- from the East or the West. The amounts due Paris Club creditors in 1983 is \$7,495 million.

Status of Rescheduling

Commercial banks are moving forward with a rescheduling for 1983; official creditors are not and are providing a 100 percent de facto rescheduling. This has the effect of the official creditors facilitating the ability of the banks (and other creditors) to be paid some portion of their debts.

Developments underlying this position on official rescheduling are as follows:

- In January 1982, the official creditors group agreed that "exceptional circumstances", existed in Poland and that the creditors group would not enter into rescheduling discussions with the GOP regarding their 1982 debt service obligations "for the time being".
- NATO members of the creditors group support a January 1982 NATO consensus not to enter into rescheduling, and established three political criteria for negotiations on rescheduling: 1) lifting of martial law, 2) release of political prisoners and 3) renewed dialogue with solidarity became controlling.

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- The GOP inquired at various times during 1982 regarding the possibility of rescheduling their debts to official creditors. They were advised that the necessary consensus did not exist.
- In October 1982 the official creditors, after receiving GOP reports entitled; the "State of the Polish Economy at the End of 1981" and "A Program for Overcoming the Crises", requested further information regarding the status of economic reform in general and in the agricultural sector in particular, clarifications on GOP balance of payments projections, status of foreign exchange reserves, export trends, debt obligations by country of origin and sectoral production goals for 1982. The Poles were expected, but did not respond to this request on January 24.
- On December 15, 1982 it was agreed by NATO members that they would not react immediately to Polish liberalization measures. Instead they would analyze those measures and prepare a list of possible graduated responses, of which debt rescheduling would be just one measure.
- At a February 2, 1983 Paris Club meeting government creditors, including the neutrals, stuck by their policy of not even reconsidering opening 1982 debt rescheduling discussions until the Poles responded to the October creditors' letter and met its financial obligations pursuant to the 1981 official rescheduling.
- An interim reply to the Chairman's letter was discussed in a subsequent Paris Club meeting the week of February 28, 1983. As the Polish letter promised to provide the requisite economic information there was a general creditors' consensus to wait for receipt of the information and continue the discussions at the April 11 Paris Club meeting.
- EC Foreign Ministers held a "political cooperation" meeting on March 1, 1983 at which they discussed inter alia Polish debt. The ten did not approve a formal statement on the discussions but did take extraordinary step of publically disclosing their dissatisfaction with existing policies which provided Poland with a de facto one hundred percent moratorium on its official debt obligations.

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Options

For 1983 Poland has \$14.8 billion total payments falling due ---- \$7.7 billion to official creditors and \$2.8 billion to commercial banks. Present estimates foresee net Polish hard currency earnings on trade and invisibles of \$1.4 billion.

The options for the official creditors are:

1. Maintain the status quo.

This would mean that the Paris Club creditors are providing a de facto 100 percent rescheduling of principal and interest on original loan contract obligations in both 1982 and 1983, thereby facilitating Polish payments to western banks.

If the banks rescheduled 1983 debt on the same terms as 1982, and continued to provide Poland with new credits equal to one-half interest payments received, they will take out net an estimated \$1.1 billion, leaving roughly \$300 million in Polish hard currency.

It is unlikely that the Poles would use these funds to pay official creditors on 1981/1982 arrearages or 1983 debt since they believe that doing so in absence of rescheduling would buy nothing for their money. Rather, it is likely they would use the remaining \$300 million to pay other creditors who would reschedule and provide new trade credits for imported inputs.

It is also unlikely that other official Paris Club creditors, especially the non-NATO members are likely to adhere to this position for an extended period of time as they seek to recover some payment, to remove themselves from the position of financing other creditors through the 100 percent de facto rescheduling, and to extend new lines of credit to aid their depressed export industries.

They can be expected, however, to continue creditor solidarity in a short-term extension of the status quo, provided they are satisfied that present discussion will lead to rescheduling negotiations, perhaps by the spring or mid-year. Pressure to do so will mount with the impending visit of the Pope in June.

2. Paris Club Creditors Reschedule - A rescheduling of principal and interest due in 1982 and 1983 would convert the existing de facto rescheduling into a de jure rescheduling.

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It is not clear just how much would be rescheduled, however, the percentage would have to be very high, given the Poland's limited financial and economic capability to generate funds for repayment.

As a condition of rescheduling, the official creditors could insist on Poland eliminating the arrears on the unrescheduled portion of the 1981 Paris Club agreement (\$200 million) and perhaps paying the interest due in 1982 on the 1981 rescheduled amounts (\$250 million). As there is a fixed amount of money available -- \$1.4 billion before a bank rescheduling and an estimated \$300 million after bank rescheduling -- a Paris Club rescheduling of less than 100 percent would result either in arrearages on the non-rescheduled portion of 1983 debt, or Poland not paying in full 1981 arrears and interest on the 1981 rescheduling.

This situation could be altered to the extent that new financing is provided. Provision of new export credits could permit the Poles to acquire inputs for production for export. This will generate -- with a significant time lag -- additional foreign exchange which may be used for debt repayments.

3. Poles Formally Declared in Default -

This is a policy which the administration has opposed as it would not place a greater burden on the Poles than at present. A formal declaration of default by one creditor would trigger the "cross-default" clauses in existing private loans to Poland and trigger a worldwide creditor scramble to attach Polish assets. Such a step would temporarily disrupt Polish trade with the west until the GOP made alternative arrangements (i.e. passing title to goods in Poland, shipping under third country flags, etc.) This would limit Poland's ability to maintain existing import levels until exports reached pre-default levels. Afterwards, Polish capacity to import would increase above levels contemplated under options 1 and 2 as the Poles would have no incentive whatsoever to service any western debts. It is important to note that implementation of "cross-default" is far from automatic and the U.S. government cannot force the banks to declare Poland in default.

Presently, the Poles believe it is in their interest to service their debt obligations to the extent possible. This is because they expect that ultimately political conditions will change sufficiently to enable them once again to obtain official rescheduling and afterwards financing (as in 1981 before the declaration of martial law) with the added possibility of IMF/IBRD assistance.

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Table 1

Poland's Financial Situation in 1982

-- Gross financing requirement	\$12,765m
-- Less trade and invisible surplus	\$ 700m
-- Equals net financing requirement (also A+B+C+D)	\$12,065m
A. Current Account Deficit	\$ 3,224m
B. Medium/Long-Term Debt	\$ 7,121m
C. Short-Term Debt	\$ 1,147m
D. Arrears from Previous Year	\$ 573m
	<u>\$12,065m</u>

This financing requirement was met through direct or indirect means:

-- Commercial bank rescheduling (95 percent principal; 5 percent deferred)	\$ 2,340m
-- Arrears to Paris Club creditors (<u>de facto</u> 100 percent rescheduling)	\$ 4,616m
-- Draw Down of Credits	\$ 1,540m
-- Gap and other arrears	<u>\$ 3,569m</u>
TOTAL	\$12,065m

*Includes \$342m in short-term credits recycled from interest payments.

TABLE 2
Commercial Bank Take Out

	<u>1983*</u>	<u>1982</u>
-- 1981 Interest Arrearages	\$ --	\$ 400m
-- Interest payments on original loan contracts	757m	837m
-- Interest on 1982 rescheduling	325m	37m
-- Interest on 1981 rescheduling	268m	380m
-- Deferred principal from 1982 rescheduling	117m	--
-- Deferred principal from 1981 rescheduling	--	126m
-- Restructuring fee from 1981 rescheduling	15m	7m
-- Rescheduling fee from 1981 agreement	<u>29m</u>	<u>--</u>
<u>Subtotal</u>	\$1,511m	\$1,787m
-- Less short-term credits equal to one-half interest received	\$ 379m	341m
Total	\$1,132m	\$1,446m

* Assumes rescheduling terms in 1983 comparable to those provided in 1982.

Table 3

Payments Due to Official Creditors

	<u>1983</u>	<u>1982</u>
-- Principal on original contract maturities	\$1,900m	\$2,573m
-- Interest on original contract maturities	1,145m	1,582m
-- Interest on 1981 rescheduling due in 1982 and 1983	250m	288m